City of Detroit

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TO: COUNCIL MEMBERS

FROM: Irvin Corley, Jr., Director ICJ.

DATE: February 10, 2009

RE: Recommend that City Council Not Disapprove the Transfer of the Cobo Hall Convention Center to the Regional Convention Facility Authority

As you know, per Public Act 554 of 2008 (Senate Bill 1630), your Honorable Body has 45 days from January 20, 2009 (Governor Granholm signed this legislation on January 16th, but it did not become effective until January 20th) or by March 6, 2009, to pass a resolution disapproving the transfer of the Cobo Hall Convention Center ("Cobo Hall") to the newly established Regional Convention Facility Authority ("Authority"), if you so choose. Otherwise, the transfer of Cobo Hall to the Authority would take place automatically 90 days from January 20th, or on April 20, 2009.

Based on my analysis of the fiscal and economic merits surrounding this deal, I recommend that your Honorable Body not disapprove the transfer of Cobo Hall to the Authority based on the following information contained herein this report.

Project Renovation/expansion Description and Economic Benefits

The transfer of Cobo Hall to the Authority would facilitate a $279 million renovation/expansion of Cobo Hall to primarily maintain the North American International Auto Show as a prominent event for the City of Detroit. Section 23 (6) of PA 554 stipulates that the Authority will not spend more than $279 million on the Cobo Hall renovation and expansion, and that any contracts associated therewith will be fixed price contracts.

Council should note that $288 million was the original figure for renovation/expansion, but this figures gets reduced by $9 million as a result of the passage of Senate Bills 880 and 881 in January, which allows for a 6% sales/use tax exemption on Cobo Hall construction materials.

According to an economic impact study of the Auto Show on the tri-county area (Wayne, Oakland and Macomb counties) conducted by renown local economist

David Sowerby, almost $600 million in economic benefits is derived from Cobo Hall (80% of which relate to the Auto Show) on an annual basis. 60% of the impact is tied to Wayne County, 30% to Oakland County and 10% to Macomb County. The economic impact study also indicated that the Auto Show generates approximately 16,600 jobs regionally on an annual basis. In addition, the Auto Show attracts approximately 6,000 international media.

$200 million would be spent on renovation of the existing Cobo Hall facility. Renovations include technology upgrades, renovation to the Cobo loading docks and improvements that directly impact the efficiency of the logistics, installing new and more energy efficient HVAC equipment, in addition to other infrastructure upgrades involving electrical, security, special systems and ADA renovations, as well as replacing furniture and carpeting. The renovations should lower operating costs (such as reducing electrical and insurance costs), lower customer costs (from the lower operating costs and improved efficiency and logistics), and improve marketability of the facility.

$79 million would be spent on the Cobo Hall expansion. The expansion would add 166,000 SF of exhibition space for a total of 866,000 SF, which would put Cobo Hall into the top 15-tier group of convention centers across the U.S. Currently, Cobo Hall is in the top 20-tier group. The expansion would also increase the ratio of meeting rooms to exhibition space by 30%.

Cobo Arena is anticipated to be a part of the expansion plan. However, if the Authority is unable to work a deal with Mike Illitch to free up the arena in lease negotiations, then the back up plan is the expand into the Riverfront Ballroom as contiguous exhibit floor space (and multi-functional space so it could be ballroom space in the future).

Cobo Hall's website lists 16 trade shows and conventions scheduled for 2009 at the facility. It is my understanding that 3 shows were cancelled last year at Cobo Hall due to limited technology and high cost structure. It is hoped the renovation and expansion of Cobo Hall would place the facility into a more competitive position to better retain and attract new trade shows and conventions in order to generate more revenue. Currently, Cobo Hall earns about the same as the convention center in Grand Rapids, Michigan, while it is three times the size.

It is also my understanding that if Cobo Hall transfers to the Authority, the Detroit Auto Dealers Association is committed to negotiating with the Authority a long-term agreement to maintain the North American International Auto Show in Detroit.

Jobs

As mentioned previously, the Auto Show generates about 16,600 jobs regionally, of which 60%, or 9,970 in jobs relate to Wayne County and City of Detroit residents.

Currently, 36 City of Detroit employees work at Cobo Hall. All of them could transfer to the Authority, along with current union and pension rights. For those who wish to remain City employees after the transfer should have bumping rights, according to union contracts. The only caveat is that bumping into existing City positions maybe difficult given that most of the positions are specifically classified as Civic Center positions.

There are no projections available on the creation of new jobs from the Cobo Hall renovation/expansion project. Obviously, a good number of temporary construction jobs would be created. In addition, it is assumed more jobs would be needed for maintenance of the newly renovated and expanded space.

Cobo Hall Purchase and Renovation/expansion Funding Source

Currently, the accommodations, or hotel tax (1.5% to 6% based on number of rooms and location in Detroit/tri-county area) from the tri-county area and the liquor tax (4% on state-wide on and off premise consumption) generate revenue that is deposited into the Convention Facility Development Fund per Public Act 106 of 1985 for the purpose of providing security on bonds or other indebtedness associated with the $180 million expansion of Cobo Hall, which was completed in 1989. (It should be noted, too, that the City of Detroit floated $26 million in general obligation bonds in 1989 to complete the expansion of Cobo Hall. According to the 2006 CAFR, it appears these bonds are now paid off.)

Based on 2006 data, Wayne County contributes 58% of the hotel/liquor tax revenue amongst the tri-county area, Oakland County 32% and Macomb County 10%.

Under PA 106, hotel/liquor tax collections from the fund first get distributed to the City of Detroit for the annual debt service payments on the bonds. Any amounts remaining from the hotel tax are used to retire the Cobo Hall bonds early. Any amounts remaining from the liquor tax get distributed to the 80 "out state" counties paid to those counties based on a proportionate share of each county's liquor tax collections. Lastly, any remaining funds from the liquor tax get distributed to the 83 counties (including Wayne, Oakland and Macomb counties) based on the amount of liquor tax collected in each county. 50% of these monies can be used for substance abuse programs (the other half are used for truth-in-taxation calculations). Unfortunately, the City of Detroit's liquor tax collections are excluded from the Wayne County total for this calculation.

Also under PA 106, outstanding bonds would be fully retired and hotel/liquor tax distributions would end in 2015. In other words after 2015, the hotel/liquor tax revenue would no longer be available for future renovation and expansion of Cobo Hall.

Fortunately, the passage of House Bill 5691 in January extends the hotel/liquor tax from 2015 to 2039, another 24 years (note: if any bonds for new renovation/expansion are paid off before 2039, then the hotel/liquor tax would cease then).

Section 12 (2) of HB 5691 stipulates the hotel/liquor tax collections can only be used to support a bond sale not to exceed $299 million for construction and acquisition costs associated with Cobo Hall. Therefore, the extension of the hotel/liquor tax through 2039, or thereabouts, would be used as security to issue bonds to pay the City of Detroit $20 million for the acquisition of the existing Cobo Hall facility and the $279 million renovation and expansion of Cobo Hall under the administration of the Authority.

Even in this difficult bond market, bond investors should consider the hotel/liquor tax revenue as solid, given its 20-year history per the existing Cobo Hall bonds supported by State law, the fact that the City of Detroit has not defaulted on these bonds, and the fact that there is enabling legislation (HB 5691) that extends these taxes for another 24 years.

<u>Cobo Hall's $20 Million Purchase Price Analysis</u>

According to PA 554 (SB 1630), if your Honorable Body does not act to disapprove the transfer of Cobo Hall to the Authority, then Cobo Hall transfers to the Authority on the 90th day of the effective date of this legislation, and the Authority pays the City of Detroit $20 million to acquire the existing Cobo Hall facility whenever the bonds are sold to pay for the acquisition, renovation and expansion of Cobo Hall.

Section 7 (3) of PA 554 considers an amount not to exceed $20 million as a fair exchange of value for value based on: a) the net value of Cobo Hall after deducting deferred maintenance obligations, operational deficits, repair or expansion needs, and other liabilities associated with the facility; b) the benefits to the City of Detroit by the Authority assuming the responsibility to pay debt obligations, operational deficits and any other liabilities associated with Cobo Hall, coupled with any additional revenues not otherwise available for the use for Cobo Hall (i.e., the allocation of cigarette tax dollars for Cobo Hall under SB 1633) and the positive economic impact likely to occur as a result of Cobo Hall's renovation and expansion in terms of creation and retention of job and capital investment; and c) any bond proceeds, debt service payments and any other money payable to the City associated with Cobo Hall after the transfer date of the facility under this act.

Using subsection a) from the above paragraph from PA 554, I consider $20 million for Cobo Hall to be fair price based on the following analysis:

Net book value (based on total $206 million expansion cost in 1989 depreciated over 20 years using a 40-year useful life on a straight-line basis; records do not indicate how much the City originally paid to open Cobo Hall in 1960, but it is assumed the construction cost has fully depreciated by now).	$103,000,000
Less:	
- **Deferred maintenance** (amount not known-Wayne County is not aware of any specific code violations or failures on the part of the City of Detroit to comply with bond convenants related to Cobo Hall).	$0
- **Operational deficits** (HB 5691 has language projecting operational deficits from 2009-2023).	($108,400,000)
- **Repair and expansion needs** (estimated renovation cost: $200 million and estimated expansion cost: $79 million)	($279,000,000)
Net value of Cobo Hall	**($284,400,000)**

The above analysis shows a negative net value of $284.4 million for Cobo Hall.

Another approach of determining value is using an income approach. It should be noted that the operational deficits figure of $108.4 million above assumes Cobo Hall operations after the renovation and expansion project. However, if Cobo Hall continued to operate without the renovation/expansion project, it is assumed the facility would continue to deficit between $13 million and $15 million annually. Using a 6% discount factor and present value calculation of these deficits over a 30-year period, Cobo Hall would end up with a negative value ranging from $179 million to $206 million. It seems the results of the net value analysis above is in the ballpark.

Unfortunately, there are no comparable sales of similar convention centers in Michigan to do a market value analysis.

And, there is simply not enough information to do a true replacement cost value analysis of the existing 700,000 SF facility based on the old technology. In 2004, the previous Administration considered the construction of a new Cobo Hall from the ground up, estimated to cost $1 billion. But this was based on a one million SF/state-of-the-art facility possibly located at another site. This is an apples to oranges comparison. But even if the replacement cost is $300 million (half of the one billion figure less depreciation based on physical deterioration and functional obsolescence less projected operational deficits), it is extremely remote that a willing buyer would purchase Cobo Hall for $300 million when the existing facility is experiencing operational deficits and several hundreds of millions of dollars may still need to be spent to retrofit the facility with current technology and efficiencies and expand the SF to 866,000 SF, as currently proposed.

Based on the above analysis, it is clear that the current Cobo Hall facility has a negative value. Therefore, $20 million would be a fair purchase price for Cobo Hall, especially when the benefits associated with the transfer of cost and liabilities per Cobo Hall to the Authority and the proposed renovation and expansion of the facility are added.

Use of the $20 Million from the Sale of Cobo Hall

Section 19 (9) of PA 554 indicates that the Authority will provide the payment of compensation not exceeding $20 million to City of Detroit for any revenue otherwise payable to the City from parking facilities operated at the Cobo Hall site, which includes Cobo Hall garage, Cobo Roof parking lot and Cobo Arena revenues as part of the parking system under the current lease/concessionaires agreement with Mike Illitch.

Currently, the Cobo parking facilities and Cobo Arena generate on average $2.4 million in net income annually for the parking system, which is owned by the Detroit Building Authority. This revenue would inure to the benefit of the Authority if Cobo Hall were transferred to it.

According to a conversation with Joe Harris, Chief Financial Officer, the $20 million paid to the City would be sufficient funds to defease any outstanding bonds on the Cobo parking facilities. Mr. Harris is basing his assessment from a conversation he had with the directors of Municipal Parking and the Detroit Building Authority and a bond financial advisor. Unfortunately, there is not a parking study report readily available to substantiate this assessment.

In addition, the Municipal Parking Department is planning to reduce outstanding parking bonds by another $10 million in order to meet the required coverage ratios pursuant to the parking bond indentures. The additional $10 million would come from reserves in various parking bond accounts, which contain almost $40 million.

In essence, it appears the $20 million payment to the City for Cobo Hall is needed to keep the parking system whole, or in other words, enable it to meet bond covenants and pay for repairs and other financial requirements on behalf of the remaining parking facilities in the City's parking system once the Cobo parking facilities are transferred to the Authority with Cobo Hall.

As a result, none of the $20 million would go the City's general fund.

Transfer of Cost/Liability of Cobo Hall to Authority and Use of Cigarette Tax

Per Sections 7 (b) and 19 (1) (e) and (9) of PA 554, the City of Detroit would no longer be responsible for any costs and liabilities, including any operational deficits, associated with Cobo Hall if the facility is transferred to the Authority.

Obviously, this is significant to the City, since it is projected that a renovated/expanded Cobo Hall by the Authority would still generated deficits in the neighborhood of $108.4 million over a 15-year period, starting in 2009. In fact, Section 10 of HB 5691 requires that any funds remaining in the Convention Facility Development Fund that is not used for debt service on Cobo Hall bonds will be distributed to the Authority to cover the projected deficits on a yearly basis until year 15, or 2023. It is simply fantastic that the State law has language in the legislation to cover projected deficits associated with the future of Cobo Hall.

In my humble opinion, it appears during negotiations that the City of Detroit agreed to go from three representatives on the Authority's board to one in order to avoid being responsible for future costs and deficits associated with Cobo Hall operations. When the City had three representatives on the board under an earlier version of the Cobo Hall deal, the City was also responsible to cover operational deficits associated with the facility.

In addition, it is very fortunate that SB 1633 requires that from 2009 through 2016, $16 million in cigarette tax collections that currently goes to Wayne County for the purpose of paying off fiscal emergency bonds and a state emergency loan, and from 2016 to 2039, $15 million in cigarette tax collections will go to the Convention Facility Development Fund in order to secure sufficient funding to pay off the debt service on the Cobo Hall bonds and cover the operational deficits.

Reversion Clause

Under Section 19 (13) of PA 554, Cobo Hall would revert back to the City of Detroit if the Authority no longer uses the facility as a convention center. The City, however, would be responsible for paying the Authority back the $20 million spent to acquire Cobo Hall.

Conclusion and Recommendation

I agree with George Jackson, President of the Detroit Economic Growth Corporation, that if your Honorable Body elects not to disapprove the transfer of Cobo Hall Convention Center to the newly established Regional Convention Facility Authority, the City of Detroit would enjoy approximately $500 million in "savings" between now and 2015 when the hotel and liquor tax would otherwise expire. The savings are quantified as follows:

$ 20	million purchase price
$100	million in debt service on the existing Cobo bonds off the City's books, which increases the City's bond capacity
$279	million invested in a major Detroit facility that the City currently does not have the ability to raise in general obligation bonds to cover, and
$ 90	million representing $15 million per year in savings in subsidizing Cobo Hall operations per year for 6 years.
$489	million in "savings" to the City of Detroit

Looking at it from a reverse direction, if the transfer does not take place, the City would be owning a major asset requiring substantial renovation (currently $200 million), not able to meet the needs of its biggest tenant (the Auto Show) and possess no revenue stream to pay for capital upgrades for the Cobo Hall facility (expired hotel/liquor tax), leading to a greater annual operating subsidy from the City of Detroit's general fund.

Based on the above analysis, I recommend that City Council choose not to disapprove the transfer of Cobo Hall to the Authority.

cc: Council Divisions
George Jackson, DEGC President
Brian Holdwick, DEGC Vice-President
Matthew Schenk, Executive Assistant to the Wayne County Executive Robert Ficano
Joseph Harris, Chief Financial Officer
Pamela Scales, Budget Director
Thomas Tuskey, Civic Center Director
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